94-1

PRICE CAP DISCUSSION
WEDNESDAY, MARCH 1, 1995
OPENING STATEMENTS OF DISCUSSION PARTICIPANTS

Please note: the attached opening statements are missing from the taped record due to the fact that side one was taped over to capture the end of the discussion.

SUMMARY OF EDUCATION/LIBRARY FCC PROPOSAL

I'm Michelle Richards, from the Federal Relations office of the National School Boards Association. I'm representing a coalition of national education and library associations who came together to respond to the Price Cap Performance Review for Local Exchange Carriers." The other members include the American Library Association; the Council of Chief State School Officers; National Association of Secondary School Principals; National Education Association.

Our proposal before the FCC was born out of the recognition that communications technology in the schools and libraries is an absolute must. It is essential to ensure that we as a nation can succeed in an increasingly technological world marketplace. It will open up new doors of educational opportunity for our children and adults.

But we recognize that connecting schools and libraries to the information infrastructure is not easy task. It is going to require a concerted public/private partnership -- and sound, creative public policy. Low end estimates of what it will cost to provide a very basic connection to all classrooms with a modem and computer are 2 billion dollars.

As a representative of school boards -- the elected citizens responsible for balancing school district budgets -- I can tell you that schools are not Fortune 500 companies. This is a task that schools can not accomplish on their own. Schools are struggling now and operating on inflexible budgets that do not allow for major new investments of this magnitude. And yet, we simply have no choice. We have to get ALL of our schools out of the technological dark ages and into the 21st century.

Our proposal to the FCC represents an important part of the solution.

We proposed that the FCC redirect the one-half percent (.5 %) "consumer productivity dividend (CPD)" allocation now contained in the price cap formula <u>from</u> a credit that currently goes to long distance carriers <u>to</u> a "credit bank" that would encourage participating local telephone companies to connect public libraries and schools to the National Information Infrastructure. Up to $300,000,000 a year could be available for this purpose.

There are other worthwhile initiatives for helping our schools and libraries get the telecommunications connectivity that they need to be able to offer a quality education, equitably and affordably, to learners of all ages, regardless of where they live or go to school. According to a 1993 NEA survey, only 12% of American classrooms have telephones; only 4% have modems. Although the CPD amount will not solve all of our needs, it will be a giant step forward. It is clear that the only way education and libraries will come to enjoy the benefits of the NII is if telecommunications policy is specifically oriented to make this happen.

If the FCC were to adopt our proposal, it would need to initiate a separate rulemaking proceeding to resolve the details involved in the implementation of such a program in the states. We are writing a proposal for such a proceeding, urging that priority be given to multi-year, community-wide plans for connecting schools and libraries, with preference given to disadvantaged areas.
The FCC has the clear authority under the Communications Act to adopt our proposal. Our proposal does not constitute a tax.

Our proposal offers the potential for a classic win/win opportunity. The education community wins because hundreds of millions of dollars will be spent each year on connecting public schools and libraries to the NII; the local telephone industry wins because it is provided with appropriate incentives to build the education telecommunication infrastructure; the public wins because the quality of education will ultimately be improved. This is not an entirely zero sum solution, since the connected schools are likely to be more significant consumers of telecom-munications services offered by the long distance industry. Thus, IXC's too are likely to benefit from our nation's schools and libraries being part of the NII.

According to a recent study by the Benton Foundation, the American public ranks education as the most important potential use of the emerging national information infrastructure. However, the only way school children and library users will have meaningful access to the NII is if telecommunications policymakers and the private sector work together, take a stand, and help make it happen.
Thank you.

Opening Statement of
John Gueldner
March 1, 1995
CC Docket No. 94-1

I am John Gueldner. I am a vice president of Pacific Bell and am joined today by my colleagues, Dr. Laurits Christensen and Dr. William Taylor. We are here representing USTA.

As the FCC addresses the next stage in the evolution of price caps, it should make its decision based on its long term vision for regulating the Local Exchange Carrier industry. The essential elements of the vision were laid out in paragraph 12 of the notice starting this review. They are:

First, a system that caps prices to create profit incentives similar to competitive markets,
second, a system that generates positive motivation for reasonable rates, productivity growth and accurate cost allocation, while reducing regulatory burdens, and
third, the carrier gains the opportunity to earn higher profits, not by raising prices, but by operating more efficiently and by developing new services.

Those of us in USTA feel that our proposal for price caps coincides with this vision. The key component in the USTA plan is an elective option that features a redefinition of productivity sharing. It proposes to utilize a 5 year rolling average actual industry total factor productivity value in lieu of the nominal productivity factor and the system of rate of return floors, ceilings, benchmarks and adjustments. USTA is willing at the same time to lower the PCI by 1% and install a temporary declining CPD of 1%, and to volunteer to invest 1% of our interstate revenues in an education fund.

But the essence of the USTA plan is to change the sharing concept to more closely emulate the competitive marketplace. In a competitive market, competition drives industry productivity gains back to customers through price reductions. To the extent that individual companies in a market can achieve efficiencies above and beyond the industry average reflected in lower market prices, the firm retains these gains as additional returns to flow to investors. These returns incent additional investment in the company. The additional investment in the company directly benefits its customer by providing more services or higher productivity.

In the last three years under price caps, the industry spent $3.5B more in total capital than during the three years prior to price caps. For the foreseeable future, into the next century, the primary challenge to the local access providers such as us will be to fund the explosive growth of our customers' needs.

At the same time that extraordinary gains will be flowing to support investment, prices will continue to come down - due both to the rolling average productivity price adjustment and to the additional reductions of prices that will occur as access competition continues to develop. This simply continues the trend that has resulted in a 25% reduction in overall interstate access charges amounting to over $5B in total since price caps began for LECs.

What is important for the commission to consider is also what happens if our recommendation is not adopted. What if the Commission continues the current mode of sharing and even raises the productivity factor to an even higher level number. Two effects occur. First, the gains do not get reflected in LEC investment, but in rebates to our LEC customers which may or may not get reflected as more infrastructure investment or price decreases. Second, such a decision sends powerful negative signals to potential investors. One needs only to read the investor analysis reports on my own state of California over the last six months following an increase in our productivity factor and lowering of the sharing threshold to see it graphically.

So the USTA urges the FCC to adopt our proposal to move LEC regulation to the next step and toward the vision that it articulated in the NPRM.

Good Morning. My name is Alan Sykes, Vice President-Revenues for Sprint's Local Telecommunications Division. Appearing with me is Jim Sichter of my staff and Rick Kapka, Director-Access Management of Sprint's Long Distance Division. Sprint appreciates the opportunity to participate in this discussion today.

In Sprint's views there are five policy goals that should drive this docket.

First, increased consumer benefit. Sprint's plan does this by:

-- Up-front real access rate reduction;
-- Access rate reductions greater than current plan;
-- Reductions are flowed through
    -- Sprint's reductions under price caps have been 20% greater than access reductions

Second, increased incentives for productivity and infrastructure investment. Sprint's plan does this by:

-- Increase productivity factor to 4.5%;
-- Eliminate sharing and lower formula adjustment mark;
-- LECs responsible for depreciation and write-downs;
-- Competition provides greatest incentive to invest;
    -- Look at what cable TV and LECs are doing to compete with each other;
    -- Need to create a record to fund an education challenge.

Third, measured steps to enhance LECs competitiveness. Sprint's plan does this by:

-- Sprint plan offers creative solutions to issues of LEC competitiveness;
    -- Targeting portion of productivity to RIC phaseout;
    -- Immediate implementation of zone density with up-front reduction targeted to high density transport rates.

Fourth, facilitate development of local competition. Sprint's plan does this by:

-- Must create environment for new entrants to emerge and be successful;
-- Must break the tie to rate of return ...eliminate sharing ...to remove disincentives from LECs;
    -- Rate of return legitimizes revenue requirements as universal service obligations;

Fifth, send a powerful message to the states that if local competition is going to develop, it is absolutely essential that rate of return regulation, sharing as it's called under price caps, must be eliminated.

I look forward to your questions.

Statement of Bradley Stillman, Consumer Federation of America

At implementation four years ago, there was a lot of guesswork involved, and the plan provided for a review four years later to see how everyone did. Well, we know everyone but the LEC's fared poorly and now the Commission must learn from our collective experience and it has an obligation to reduce access charges to yield just and reasonable rates.

The fact is, failure to re-initialize rates which are yielding a nearly 14% rate of return, even if the Commission gets the productivity factor exactly right this time, is still a guarantee that captive ratepayers long distance rates will remain billions of dollars too high. It is bad enough that consumer's were forced to pay excessive rates for the past four years, they shouldn't be forced to artificially enrich the local monopoly companies forever into the future.

Just at the time when the consumer insurance policy, sharing, is going to pay dividends, the local exchange monopolists are trying to get rid of it. This essential consumer safety net is only invoked if the Commission is in error again on the appropriate productivity factor or if this dynamic industry experiences unforeseen changes during the term of the plan. In either case, consumers should share in the benefits of increased productivity. If the Commission hits the mark on productivity, sharing will not be triggered and no additional regulatory requirements will occur. Just as the companies are protected from rates that are so low as to be confiscatory in nature, consumers should have protection against rates that are so high as to be unjust and unreasonable.

Price caps have not yielded the increased network investment which was touted as one of the reasons to adopt such a scheme in the first place. Indeed, as earnings of the LEC's have climbed, network investment vis a vis historical levels has not markedly changed. The only thing that will really increase network investment effectively is the onset of local competition.

A price cap plan, even with sharing, is by no means a rate of return regulatory scheme. The Commission stated that it believed price caps would yield just and reasonable rates. The fundamental question in this review then, is how do you measure the effectiveness of the price cap formula?

The LEC's would basically say, "You don't." This scenario, so desirable to the companies, would result in the Commission abdicating its continuing regulatory responsibilities at the expense of consumers. To judge a regulatory system based on price, you no longer look at the comprehensive cost data of the companies. But there still must be a measurement of whether the regulatory scheme, even one based on price, is operating to the mutual benefit of consumers and the companies. To do so, you look to earnings.

Before I conclude, I must mention briefly the issue of wiring schools and libraries. While this is a socially desirable policy, it is inappropriate and unfair to take the money from the pockets of captive telephone ratepayers through a totally unrelated proceeding, with an anti-competitive plan that leaves the decision of if, how and when to wire up to the local telephone monopoly. There should be no hollow *quid pro quo* in this proceeding. It is unlikely to achieve the goals shared by the public interest community and in the unlikely event that it does, it will do so at a hyper-inflated price.

The elimination of sharing and the failure to re-initialize rates based on the cost of capital is the Commission simply saying to captive ratepayers, "Sorry we got it wrong, but too bad." To meet it's statutory obligation, the Commission must re-initialize rates down to 10%, apply a productivity factor of at least 5.7% and retain the consumer's insurance policy, sharing.

OPENING STATEMENT
OF
DONALD F. EVANS
ON BEHALF OF CARE

CARE would like to thank the organizers of this debate for inviting us to participate. We are a very diverse group that represents consumers, both large and small, and IXCs. Our membership includes The National Association of State Utility Consumer Advocates, ICA, CFA, the Ad Hoc Telecommunications Users Committee, API, AT&T, and MCI. Each of us began this review independently. Despite our diversity, we have found our views as to what the Commission needs to do in this docket to be fundamentally consistent. We have met with a number of you to discuss what we believe must be accomplished through this price cap review. I'll recap those points in closing. First I want to focus you on what we believe <u>your goals</u> should be for price cap regulation.

The goal of price caps, or any form of regulation, is to simulate a competitive environment when no such environment exists. In refining its price cap regulations, the Commission should not take its eye off the ball. The regulations adopted must achieve two objectives. First, the system must produce reasonable rates in order to protect ratepayers. To us, reasonable rates means that the regulatory system must replicate the efficiency incentives of a competitive market. Second, the regulations must foster growth of an effectively competitive access market.

We represent American consumers and we know what we want.

The current form of price cap regulation is tilted heavily in favor of the local exchange carriers, who have benefitted substantially and excessively during the first four years of price caps. If the plan is not fixed now, it will cost consumers an additional $8.5 billion over the next four years. Those benefits must be realigned. Access prices, which have remained flat over the last four years, must once again begin to move toward their economic cost if the goal of price cap regulation is to be met.

To properly balance the benefits of price caps, consumers have asked the Commission to take three steps. First, we are looking to the Commission to raise the productivity factor to 5.7 percent, a conservative step considering that record evidence supports a factor as high as 8.4%. Second, the Commission should make a one-time adjustment to the price cap indexes to reflect a lower cost of capital. The LECs have been the recipients of a tremendous windfall in the last four years as a result of the dramatic and sustained drop in the cost of capital from the FCC's prescribed 11.25% to 10.0%. Third, the Commission must retain sharing to ensure that the benefits of future productivity flow to ratepayers.

The FCC could perform no greater service to the economy than to subject LEC investment decisions to a regulatory structure that simulates a competitive environment. If decisions about the index are made well and correctly, there are tremendous benefits to be gained. Access charges will, over time, be driven closer to their true economic cost. The LECs themselves will have strong incentives to increase productivity.

You should be very skeptical of any suggestions that you engage in horse-trading of price cap index levels for promises of future investment in the LEC access network. Infrastructure investment is at the same level it was under rate of return. Even though the LECs have generated billions more in earnings at the expense of ratepayers, they haven't gone on an infrastructure investment spree. Rather, they have used these funds to subsidize their forays into offshore investments in other countries' infrastructures, program production with Hollywood moguls, and other non-telephony businesses.

Finally, I want to address LEC arguments that consumers will not see lower long distance rates because the long distance carriers will pocket the savings from lower access charges. Since divestiture, interstate long distance rates have fallen more than interstate usage sensitive access charges. The LECs' argument is historically inaccurate, and is, we are confident, a mischaracterization of what is likely to happen in the future.

We look forward to a spirited and informative debate.

Attachment A

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